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IN THE

Supreme Court of the United States

OCTOBER TERM, 1956.

No. 460

HERMAN PASTER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit, entered in the above entitled case on June 21, 1957.

CITATION TO OPINIONS BELOW.

The opinion and findings of fact of the Tax Court of the United States in Docket No. 38018 were filed on June 20, 1956, and the decision was rendered on August 22, 1956, and reported as 56144 T. C. Memo. The opinion of the Court of Appeals for the Eighth Circuit, printed as Appendix A hereto, is reported at 245 F. 2d 281.

JURISDICTION.

The judgment of the Court of Appeals was entered on June 21, 1957, and the jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

QUESTION PRESENTED.

The question presented here is whether the profits paid to the Trusts by the Mayflower Distributing Company are income taxable to the Trusts or whether such profits are income taxable to the Petitioner.

STATUTE INVOLVED.

Sec. 22, Internal Revenue Code 1939:

GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly. In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income.

STATEMENT OF THE CASE.

The petitioner from 1937 to January 31, 1946, (R. 17-19) was employed by the Mayflower Distributing Company, a partnership, and was compensated by a salary plus a percentage of the profits. The petitioner at no time during this period had any proprietary interest in, or control of, the partnership.

On December 29, 1942, (R. 19) the petitioner executed three separate irrevocable trusts, for the benefit of his wife and two children, respectively, which trusts provided (Exhibits 4a, 4b, 4c):

> "8. This trust shall remain in force and in effect until November 18, 1960, at which time the trust shall terminate and all funds, both principal and accrued income, then in the hands of the trustees shall be paid over and delivered to the beneficiary."

Simultaneously with the creation of the trusts the petitioner irrevocably transferred to each of the Trusts Ten Thousand Dollars ($10,000.00) out of the moneys due him from the Mayflower Distributing Company. (R. 19) These sums were transferred to the Trusts on the books of the Mayflower Distributing Company as of January 31, 1943, at which time Mayflower Distributing Company was indebted to the petitioner in the sum of $51,511.82 (Exhibit 5, Ledger Acct. Mayflower). (R. 21)

In January of 1943, subsequent to the creation of the three Trusts, the petitioner, as Trustee, on behalf of the Trusts, entered into an agreement with the Mayflower Distribution Company which provided that the initial trust corpus, an aggregate of $30,000.00, (R. 14, 32) would demain in the Mayflower Distributing Company as working capital and would not be withdrawn by the Trusts without the consent of the company. In consideration for the Trusts thus investing the $30,000.00, the company agreed to pay each Trust 7% of its annual profit. (R. 14)

In compliance with this agreement the Trusts received their share of profits from the Mayflower Distributing Company for the years ending January 31, 1944, 1945 and 1946. (R. 21, 22, 23)

The three Trusts in question filed income tax returns for the years 1944, 1945 and 1946, and each Trust reported and paid a tax upon its share of profits of the Mayflower Distributing Company.

The respondent here determined that the profit which Mayflower Distributing Company paid to the Trusts, which the Trusts reported and paid a tax thereon, was not income of the Trusts but was income of the petitioner and assessed a tax for said income against the petitioner.

The Tax Court approved this determination and held that the profits paid to the Trusts by Mayflower was income to the petitioner and taxable to him, from which decision the petitioner appealed. The decision of the Tax Court was affirmed by the Court of Appeals, which decision is sought to be reviewed here.

REASONS FOR GRANTING WRIT.

I. The decision here is in direct conflict with, and a misapplication of the decisions of the Supreme Court in:

(A) *Helvering* v. *Clifford*, 309 U.S. 331, 60 S. Ct. 554.

(B) *Blair* v. *Commissioner*, 300 U.S. 5.

(A) The decision in the instant case squarely conflicts with the decision in *Helvering* v. *Clifford*, *supra*, which established the principle that the income of a trust is taxable to the grantor, only where the grantor remains the owner of the trust corpus after the creation of the trust.

The Supreme Court in the *Clifford* case concluded that the grantor remained the owner of the corpus of the trust after its creation, stating (Pages 556 and 557):

"In this case we cannot conclude as a matter of law that respondent ceased to be the owner of the corpus after the trust was created. Rather, the short duration of the trust, the fact that the wife was the beneficiary, and the retention of control over the corpus by respondent all lead irresistibly to the conclusion that respondent continued to be the owner for purposes of § 22(a)." * * *

But when the benefits flowing to him indirectly through the wife are added to the legal rights he retained, the aggregate may be said to be a fair equivalent of what he previously had. * * * In those circumstances the all-important factor might be retention by him of control over the principal. With that control in his hands he would keep direct command over all that he needed to remain in substantially the same financial situation as before. * * * Thus, where, as in this case, the benefits directly or indirectly retained blend so imperceptibly with the normal concepts of full ownership, we cannot say that the triers of fact committed reversible error when they found that the husband was the owner of the corpus for the purposes of Section 22(a)."

In the *Clifford* case the tax was assessed against the grantor by virtue of the existence of three elements considered in the aggregate:

(a) the short duration of the trust;

(b) the fact that the wife was the beneficiary; and

(c) the fact that the grantor retained control over the corpus.

A decisive and essential factor was the fact that the grantor in the *Clifford* case retained extensive *legal rights* in the corpus of the trust, consisting of the right to revestment of and control over the corpus and distribution of the income. In the words of the Court, " : . . when

the benefits flowing to him indirectly through the wife are added to the legal rights he retained, the aggregate may be said to be a fair equivalent of what he previously had . . . ".

The grantor, Herman Paster, irrevocably transferred the corpus to the trusts, without right to revestment and without right to any income presently or in the future. (Exhibits 4a, 4b, 4c).

Since in the instant case the petitioner retained no legal ownership in the corpus and no right to control the distribution of income, it is obvious that the Court of Appeals in the instant case did not follow the principle in the *Clifford* case.

(B) In *Blair* v. *Commissioner, supra,* the petitioner, Edward Blair, was the beneficiary of a trust created by his father, under the provisions of which he was entitled to receive one-half of the income. The petitioner assigned to his daughter a portion of the beneficial interest in the trust. The Commissioner maintained that the assignment was ineffective and that the income from the assigned interest was taxable to the assignor. Both the Tax Court and the Court of Appeals affirmed the Commissioner's position.

The Supreme Court reversed and held that the assignment was valid and the income was taxable to the assignee and not to the assignor. The Supreme Court held that the decisions in *Lucas* v. *Earl,* 281 U.S. 111, and *Burnet* v. *Leininger,* 285 U.S. 136, upon which the Court of Appeals relied, were not in point or controlling and stated at page 333:

> "In the instant case, the tax is upon income as to which, in the general application of the revenue acts, the tax liability attaches to ownership. (Citing cases) • • •"

The Court stated further (page 333):

> "The one who is to receive the income as the owner of the beneficial interest is to pay the tax. If under the law governing the trust the beneficial interest is assignable, and if it has been assigned without reservation, the assignee thus becomes the beneficiary and is entitled to rights and remedies accordingly. We find nothing in the revenue acts which denies him that status."

In the *Blair* case the income in issue came from the beneficiary's interest in the trust. Analogously, in the instant case the income in issue derived from the funds irrevocably transferred to the trusts by the grantor. Therefore, under the principle in the *Blair* case, the Trusts being the owner of the beneficial interest, the income in the instant case is taxable to the trusts and not to the grantor. Accordingly the decision in the instant case is in conflict with the principle in the *Blair* case.

II. The decision here is in conflict with the decisions of other Courts of Appeals in:

(A) *Commissioner* v. *Bateman*, 127 F. 2d 266, CCA 1.

(B) *Commissioner* v. *Reece*, 233 F. 2d 30, CCA 1.

(A) The *Bateman* case, *supra*, is in conformity with the *Clifford* case *supra*, and the *Blair* case, *supra*, but is contrary to the instant case. In the *Bateman* case the taxpayer created a trust whereby 5% of the annual income was to be retained by the trustee and added to the corpus. The taxpayer retained the power to distribute by Will all of the corpus. The question was whether the taxpayer retained such ownership of the trust so that the 5% accumulated income was taxable to her and not to the trust.

In holding that the taxpayer did not retain such ownership so that the income in issue was taxable to her, the Court stated (Page 253):

"By the trust indenture the taxpayer irrevocably surrendered up control over investment and reinvestment of the corpus, and voting rights to the stock. In no event may she be revested with title to the corpus. She can no longer spend or give away the principal of the income during her lifetime. Assuming she has other property ample for her needs, it still is difficult to deny that as to the property she conveyed to trustees she gave up such substantial rights normally associated with the concept of "full ownership" that she should no longer be deemed in substance the "owner" of the corpus within the rationale of the *Clifford* case."

The facts in the instant case are comparable to those in the *Bateman* case. The taxpayer in the instant case retained no power (except as trustee) to control the corpus of the estate, no part of the corpus was to be revested in the taxpayer, and he had no right to any of the income at any time. In short, here petitioner divested himself of ownership completely and in every respect, so that it can not be said that he was the owner of the trust either in law or in fact.

(B) The case of *Commissioner* v. *Reece, supra*, held that a royalty contract could be assigned and that the future royalties would be taxable to the assignee and not to the assignor, even though the assignment was to the assignor's wife. The Court held that where there was an absolute genuine assignment the income would be taxable to the assignee.

In this case Reece assigned his patent rights to Universal Winding Co. on February 20, 1929. Thereafter a patent was issued to Universal Winding Co. on April 4, 1930. The consideration for the assignment of this patent to Universal Winding Co. was the payment of $2500.00 plus a royalty, and in 1930 he received $7500.00 advance on these royalties. Universal Winding Co. agreed

to and made payments up to December 26, 1935, on which date Reece assigned the entire royalty contract to his wife.

The Court held that since there was an absolute assignment of the contract, even though it was to the wife, and since the assignment was genuine, the income was taxable to the assignee, wife, and not to the assignor, husband.

The Court, in an exhaustive analysis of the subject, stated at page 34:

> "The income in the case at bar is admittedly not income "derived from salaries, wages, or compensation for personal service," for Reece never was in the employ of Universal Winding Co. Therefore, the holding in *Helvering* v. *Eubank* does not apply. In cases of income derived from property, we must accept, in deference to *Harrison* v. *Schaffner*, 1941, 312 U.S. 579, 61 S. Ct. 759, 85 L. Ed. 1055, that where the taxpayer retains the "tree" and purports merely to assign the "fruits" thereof, the fruits remain thereafter, and not only in the year in which the assignment was made, taxable as income of the assignor, on the metaphorical concept that the assignment fails to minimize the assignor's taxable income because it is a futile attempt to attribute the fruits "to a different tree from that on which they grew." (Citing Cases) In cases like *Helvering* v. *Clifford* * * * the question is whether the benefits directly or indirectly retained by the assignor blend imperceptibly "with the normal concepts of full ownership", so that it is reasonable to conclude that the assignor remains "in substance" the owner of the corpus—the "tree"—and therefore that the income therefrom may fairly be attributable to the assignor. * * * "
>
> "Also it is clear that the present case is not ruled by *Helvering* v. *Clifford, supra*, and its progeny, nor by *Harrison* v. *Schaffner, supra*, for as above stated the taxpayer after the assignment of December 26,

1935, retained absolutely nothing relating to the subject matter—not the 'tree,' nor anything which could be said to blend imperceptibly 'with the normal concepts of full ownership.' Since the assignment to Mrs. Reece was not of 'salaries, wages, or compensation for personal service' earned by the taxpayer, the issue is as stated by the Supreme Court in *Commissioner* v. *Sunnen*, 333 U.S. 591, 604 (1948): 'The crucial question remains whether the assignor retains sufficient power and control over the assigned property or over receipt of the income to make it reasonable to treat him as the recipient of the income for tax purposes.' • • • •"

"Our conclusion is that it is impossible to read • • • the code as meaning that Congress intended to tax as 1947 income of this 'individual' taxpayer the payments received during the year by Mrs. Reece from the Universal Winding Co. pursuant to the taxpayer's 'absolute assignment' to her in 1935 of all his rights under the contract of 1929 with the Universal Winding Co. As square authority for this conclusion we may cite *Nelson* v. *Ferguson*, 3 Cir. 1932, 56 F. 2d 121, *certiorari* denied • • •.

In the instant case the taxpayer made an irrevocable transfer to the trust and thereby divested himself of all ownership or control of both the corpus and any resultant income. He effected a transfer of the "tree" in its entirety, including any "fruit."

III. The decision of the Court of Appeals here is in error by reason of the fact that the Court misapplied the controlling applicable rules of evidence.

The Court of Appeals affirmed the Tax Court's decision on the ground that the determination of the Commissioner's deficiency "was presumptively correct and the burden was on the taxpayer to prove otherwise", and that, "the proof was without dispute that the corpus of these alleged trusts belonged to the taxpayer." (Ap. 14a)

In reaching this decision the Court of Appeals failed to apply the rule of evidence that:

> The presumption of correctness of the Commissioner's determination disappears when sufficient evidence to sustain a contrary finding has been introduced.

With respect to the weight to be accorded the doctrine of "presumption of correctness" of the finding of the Commissioner, a leading case is *Crude Oil Corporation of America* v. *Commissioner of Internal Revenue*, 161 F. 2d 809. In that case the Tax Court held that the presumption of delivery of the mail was insufficient to overcome the presumption of correctness of the Commissioner's determination that the tax return was not filed. In passing upon the treatment of evidence by the Tax Court, the Court of Appeals held: (P. 810)

> "We think the Tax Court fell into an error of law. The presumption of the correctness of the Commissioner's finding is one of law. It is not an inference of fact. It disappears when evidence, sufficient to sustain a contrary finding, has been introduced."

A statement of the principle was set forth in *Wiget* v. *Becker*, 84 F. 2d 706, in which case the learned Judge (who wrote the decision here appealed from) had this to say (page 708):

> "The presumption of correctness is in the class of the 'burden of proof presumption.' *Morrison* v. *People of California*, 291 U.S. 82, 54 S. Ct. 281, 78 L. Ed. 664; *Casey* v. *United States*, 276 U.S. 413, 48 S. Ct. 373, 72 L. Ed. 632. The party against whom it is invoked must fail if he does not produce evidence against it. It is often referred to in the books as the true presumption. 'A true presumption is not evidence, though it supplies its place and requires the other party to proceed with the negative. Unless he does he loses;

when he does, the presumption is out of the case, and the issue is open.' *United States ex rel.* v. *Pulver* (C.C.A. 2) 54 F. (2d) 261, 263. See, also, *United States* v. *Le Duc* (C.C.A. 8) 48 F. (2d) 789; *Fidelity & Cas. Co.* v. *Niemann* (C.C.A. 8) 47 F. (2d) 1056; *Del Vecchio* v. *Bowers*, 296 U.S. 280, 56 S. Ct. 190, 193, 80 L. Ed. 229. * * *

The conclusions of law in the instant case show that the lower court gave to the presumption of correctness of the commissioner's finding 'the attribute of evidence in the claimant's favor.' Here, both parties submitted substantial evidence on the issue before the court, and in that state of the record the presumption passed out of the case."

In the case of *Del Vecchio* v. *Bowers*, 296 U.S. 280, the Court, on the question of presumption, stated (Page 285):

"The question is whether, as the court below thought, the presumption has the quality of affirmative evidence. The answer must be that it has not."

In the *Del Vecchio* case the evidentiary question was as to the effect or weight to be given the presumption that death is accidental rather than suicidal. The Court in holding the the doctrine of presumption was not involved, stated (Page 286):

"Once the employer has carried his burden by offering testimony sufficient to justify a finding of suicide, the presumption falls out of the case. It never had and cannot acquire the attribute of evidence in the claimant's favor. Its only office is to control the result where there is an entire lack of competent evidence."

The Court of Appeals apparently regarded the doctrine of presumption of correctness as having the quality of affirmative evidence. This, of course, was erroneous. When the petitioner submitted its evidence—and this was the

only evidence submitted—the presumption "passed out of the case," and the determination could be made only upon the evidence adduced, and without any regard to a presumption.

The petitioner has offered undisputed evidence that neither the trust nor its income belonged to the petitioner (R. 11-12-13) and as a result of such evidence the "presumption" fell out of the case.

The Court of Appeals in sustaining the decision of the Tax Court also failed to follow the rule of evidence that:

> The decision of the Tax Court must be based on substantial evidence.

That substantial evidence is lacking here.

In its decision in the instant case the Court of Appeals quoted *Doll* v. *Commissioner of Internal Revenue*, 149 F. 2d 239. In the *Doll* case the Court of Appeals for the Eighth Circuit quite clearly stated: (page 244)

> "Determination of such fact situation is the exclusive province of the Tax Court and its decision must be upheld if based upon substantial evidence"

In *Commissioner of Internal Revenue* v. *Scottish American Inv. Co.*, 323 U.S. 119, the Court stated: (page 124)

> "And when the Tax Court's factual inferences and conclusions are determinative of compliance with statutory requirements, the appellate courts are limited to a determination of whether they have any substantial basis in the evidence. The judicial eye must not in the first instance rove about searching for evidence to support other conflicting inferences and conclusions which the judges or the litigants may consider more reasonable or desirable. It must be cast directly and primarily upon the evidence in support of those made by the Tax Courts."

See also *Helvering* v. *Kehoe* and cases therein cited—309 U.S. 279.

The Court of Appeals in support of its decision in the instant case states (Ap. A. 14a):

> "Taxpayer asserts that the decision of the Tax Court finds no affirmative evidence in its support. There was, however, the determination of the Commissioner of the deficiencies in taxpayer's income tax returns. This was presumptively correct and the burden was on taxpayer to prove otherwise. The proof was without dispute that the corpus of these alleged trusts belonged to the taxpayer and there were the attending circumstances which, except for certain testimony of the taxpayer and the testimony of the bookkeeper of the concern over which taxpayer had complete control and which the Tax Court was not obliged to credit, conclusively showed that the taxpayer had complete dominion and control, with all the attributes of ownership, over these so-called trust funds. There was, as heretofore been indicated, no evidence that the beneficiaries ever exercised any control over these so-called trust funds."

The evidence introduced here dispels whatever presumption of correctness the determination of the Commissioner had. The Court stated that "the proof was without dispute that the corpus of these alleged trusts belonged to the taxpayer * * *." There is no evidence to support this statement. In fact, all of the evidence and the only evidence offered in this respect is to the contrary.

The undisputed evidence is that the petitioner created the trusts, transferred a fund to the trusts, that the fund was invested and the earnings of the investment were paid to the trusts and that no part of the corpus or earnings were under the control of the petitioner. (R. 10, 12, 13).

There is absolutely no evidence to support the Court's conclusion that the grantor was the owner of the corpus and that he was entitled to receive or control the income of the trusts.

The Court of Appeals further states, ". . . there were the attending circumstances which . . . conclusively showed that the taxpayer had complete dominion and control with all the attributes of ownership over the so-called trust funds." This comment of the Court is simply an assertion and no basis can be found for it in the record, since the only evidence adduced was to the effect that there was no control or dominion by the petitioner over the trust corpus or trust income and that he possessed none of the attributes of ownership.

The Court apparently gave considerable weight to its conclusion that the beneficiaries never exercised any control over the trust funds and considered this to be a material factor in reaching its decision. It is respectfully submitted that the matter of control over the trust funds exercised by the beneficiaries has nothing to do with the issues in the case at bar. Control over the trust funds was delegated to the trustees in their fiduciary capacities as trustees. The question is, did the taxpayer divest himself of dominion and control as an owner of the trust funds, and not whether dominion and control of such funds passed to the beneficiaries, who customarily do not have any control over trust funds—that being the very object of most trusts.

The Court of Appeals erred when it concluded that there was sufficient evidence to support the decision of the Tax Court.

IV. The Court of Appeals erred in concluding that under the decisions in certain cases the taxpayer here must be held to be the owner of the corpus.

The Court of Appeals asserted that (Ap. A. Page 8a) upon the authority of *Commissioner* v. *Sunnen*, 333 U.S. 591; *Helvering* v. *Clifford*, 309 U.S. 331; *Helvering* v. *Horst*, 311 U.S. 112; *Doll* v. *Commissioner of Internal Revenue*, 149 F. 2d 239; and *Yiannias* v. *Commissioner*, 180 F. 2d 115, as a matter of law it is required to hold that the taxpayer should be treated as the owner of the corpus. It is rspectfully submitted that the Court misinterpreted the effect or meaning of these decisions with respect to the case at bar.

These cases do not require or justify such holding, since the facts in these cases are not comparable to the facts at bar.

In *Commissioner* v. *Sunnen*, *supra*, the Court held that notwithstanding the taxpayer's assignment of the rights and contracts to his wife, the taxpayer nevertheless retained substantial interest in the contracts as well as power to control the payment of the royalty to his wife, thereby satisfying the various criteria of taxability as set forth in the *Clifford* and *Horst* group of cases. As reason for this holding the Court there stated as follows: (page 724)

> "As president, director and owner of 89% of the stock of the corporation, the taxpayer remained in a position to exercise extensive control over the license contracts after assigning them to his wife. The contracts all provided that either party might cancel without liability upon giving the required notice. This gave the taxpayer, in his dominant position in the corporation, power to procure the cancellation of the contracts in their entirety. That power was nonetheless substantial because the taxpayer had but one of the three directors' votes necessary to sanction such

action by the corporation. Should a majority of the directors prove unamenable to his desires, the frustration would last no longer than the date of the next annual election of directors by the stockholders, an election which the taxpayer could control by reason of his extensive stock holdings. The wife, as assignee and as a party to contracts expressly terminable by the corporation without liability, could not prevent cancellation provided that the necessary notice was given."

In the instant case, unlike the control which the petitioner had in the *Sunnen* case, the petitioner, Paster, had no control over the trust corpus or over the income earned by the trusts, nor could he deprive the trusts of the income or change or modify the amount under the trust investment contract with the Mayflower Distributing Company. Paster had absolutely no control over whether the trusts would have any income from the investment or its amount.

Neither is the case of *Doll* v. *Commissioner*, 149 F. 2d 239, 33 AFTR 1264, controlling or applicable in the case here. In the *Doll* case the husband and wife claimed they were partners and the Court held that they were not. That was purely a matter of fact and the finding of the Tax Court was there fully supported by the evidence so that the Court of Appeals affirmed the holding of the Tax Court based upon the evidence. This case had nothing to do with trusts or the assignment of income from any trusts or contracts.

Similarly, the case of *Yiannias* v. *Commissioner*, 180 F. 2d 115, does not control the issue here and does not justify the conclusion reached. In the *Yiannias* case the taxpayer transferred his partnership interest to his wife. However, he continued to render the same managerial

services to the partnership as required of him under the terms of the partnership prior to the assignment. In addition, he was not relieved of any of his financial or legal obligations as a partner, which were in existence prior to the assignment. Petitioner's wife rendered no services or furnished no capital to the partnership. Although the petitioner gave notice to the partnership of the assignment to his wife, the record failed to disclose any consent by the partnership to such assignment or that the partnership recognized the wife as a partner. The Court held that the husband did not make a valid and effective assignment of his partnership interest and that he was still a member of the partnership, and, therefore, the income was taxable to him.

In the instant case there is no question of any assignment by Paster of any rights that he had in the Mayflower Distributing Company partnership. His status was merely that of an employee. The income for which he is sought to be taxed was income earned by the trusts by reason of an investment of trust funds in the Mayflower Distributing Company. The investment by the trusts had no effect on Paster's income from the partnership, nor did he by creating the trusts transfer or divert any of his income to the trusts.

Neither does the decision of *Helvering* v. *Clifford*, *supra*, require the holding as a matter of law that under the facts in this case the petitioner must be treated as the owner of the corpus.

The Court of Appeals in its decision on page 13 states: (Ap. A. 13a)

> "The test applied in the *Clifford* case was whether a conveyance by taxpayer in trust for his wife had made 'any substantial change in his economic position,'

309 U.S. at page 336, 60 S. Ct. at page 557, 84 L. Ed. 788. The family relationship does not preclude arrangements between its members which will affect tax liability. * * *"

On the contrary, it is the petitioner's contention that the *Clifford* case requires a holding that the petitioner is not the owner of the corpus, since here the evidence definitely shows that there has been a substantial downward change in the taxpayer's financial economic position.

This Court in considering an issue such as involved here stated in *Commissioner* v. *Sunnen*, 68 S. Ct. 715, at page 722:

> "The crucial question remains whether the assignor retains sufficient power and control over the assigned property or over receipt of the income to make it reasonable to treat him as the recipient of the income for tax purposes."

Since the controlling factor determining ownership of the trust is whether the settlor retains sufficient power and control over the transferred property and income, the Tax Court and the Court of Appeals erred in holding that the trust income here was taxable to the grantor in view of the record disclosing:

1. That the grantor created irrevocable trusts and irrevocably transferred the property to the trusts, and forever divested himself of any dominion or control of the trust corpi or income.
2. That the income of the corpus of the trusts is the sole and irrevocable income of the trusts and cannot be converted or used for the benefit of the grantor.
3. That the Trust Indenture prohibits any of the corpus or income being transferred to or for the benefit of the grantor under any circumstances.

CONCLUSION.

For the foregoing reasons, the petition for writ of certiorari to the United States Court of Appeals for the Eighth Circuit should be granted.

Dated, this 12th day of September, 1957.

Respectfully submitted,

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APPENDIX A.

OPINION.

UNITED STATES COURT OF APPEALS

For The Eighth Circuit

No. 15,703

Herman Paster, Petitioner,
vs.
Commissioner of Internal Revenue, Respondent.

Petition to Review Decision of the Tax Court of the United States.

[June 21, 1957.]

Maurice Weinstein for Petitioner.

Carolyn R. Just, Attorney, Department of Justice (Charles K. Rice, Assistant Attorney General, and Hilbert P. Zarky, Attorney, Department of Justice, were with her on the brief), for Respondent.

Before Gardner, Chief Judge, and Vogel and Van Oosterhout, Circuit Judges.

Gardner, Chief Judge.

This matter is before us on petition to review a decision of the Tax Court of the United States wherein the Tax Court affirmed the action of the Commissioner of Internal Revenue in determining deficiencies in petitioner's income

tax for the fiscal years ending January 31, 1944, 1945 and 1846 in the respective amounts of $40,768.14, $24,588 and $34,637.69.

In the year 1937 one Samuel Taran took over from taxpayer a business then being operated by him under the name of Mayflower Novelty Company. The business was that of selling and distributing novelty equipment such as juke boxes, pinball machines and bowling alleys. At all times thereafter and until on or about January 31, 1946, the business was operated under the exclusive management and control of taxpayer at which time taxpayer purchased the business and became the sole owner. Income tax returns indicated that the business was that of a partnership composed of Samuel Taran, who was taxpayer's wife's uncle, Taran's nephew, J. H. Nilva, and a trust denominated as "S. H. Taran, J. H. Nilva Trust". Initially taxpayer's compensation was fixed at $35 per week plus 15% of the profits of the business. On some date not definitely shown, possibly late in 1939, taxpayer's compensation for services to Mayflower was increased to $75 per week plus 20% of the net profits and at the close of the fiscal year ended January 31, 1943, Mayflower, according to its books, was indebted to him for services rendered in the amount of $51,511.82.

In the meantime and under date of December 29, 1942, taxpayer executed three instruments entitled respectively "Herman Paster—Trust Agreement for the Benefit of Celia Paster", "Herman Paster—Trust Agreement for the Benefit of Donald Joseph Paster" and "Herman Paster—Trust Agreement for the Benefit of Edward Jacob Paster". In each instrument it was recited that taxpayer had "transferred, assigned, set over and delivered * * * unto himself and Sam Walzer" as trustees "A Ten Thousand ($10,000.00) Dollar interest in the proceeds due Herman

Paster as earnings for services rendered to the Mayflower Novelty Company." Celia Paster is taxpayer's wife and Donald Joseph and Edward Jacob are his sons. Except as to the named beneficiaries and the dates for termination of the trusts the instruments were identical and among other things each instrument recited that the trustees should have full power to sell, buy and manage any property comprising the trust property, "to collect, recover, and receive the income thereof and therefrom", and should not be responsible for any loss or damage which might result from the exercise of judgment or discretion "nor for any moneys or property except such as shall actually and in fact come into their possession" under the instrument; that no part of the income should be used to pay any life insurance premiums on policies on the life of taxpayer; that at least fifteen per cent of the income should be distributed annually to the beneficiary and the remainder distributed or retained as corpus in the discretion of the trustees; that the trusts should terminate on November 18, 1960, in the cases of Celia and Donald Joseph, that date being Donald Joseph's twenty-first birthday, and in the case of Edward Jacob on August 22, 1962, which would be his twenty-first birthday; that in the event of death of the beneficiary distributions were to go to issue, and there being no issue, to heirs at law; that the trustees should "keep and maintain separate books and records covering the trust estate"; that the trust was irrevocable and should not be capable of modification except as in the instrument specifically authorized and directed; that additions to the trust res might be made by taxpayer or others by the execution to that effect by the contributor of an instrument in writing and written acceptance thereof by the trustees, and that each trustee should receive $100 per year as compensation for his services. Each instrument also contained other provisions not here material.

Under date of February 1, 1943, the $51,511.82 credited to taxpayer on Mayflower's books for services rendered was entered in an account entitled "Note Payable—H. Paster". Of the $51,511.82 there was no withdrawal of the $30,000 purportedly assigned by taxpayer to himself and Sam Walzer, his brother-in-law, as trustees under the trust instruments but under date of February 1, 1943 a debit of $30,000 was entered in the "Note Payable—H. Paster" account under the description "trans to Note payable—H. Paster, S. Walzer trust" and under the same date an account entitled "Note Payable—H. Paster, Sam. Walzer Trust" was credited in the amount of $30,000 as "Amt set up as trust investment."

At the close of the fiscal year ended January 31, 1944, and as "Profits accruing to Trusts fiscal year end 1/31/44," 051,519.81 was entered as a credit to the above "Note Payable—H. Paster, Sam Walzer Trust" account. The amount so entered had been taken from a memorandum or tabulation prepared by Walter Johnson, Mayflower's bookkeeper. On this tabulation entitled "Mayflower Distributing Co.—Determination of moneys due others—year 2/1/43-1/31/44," and after Mayflower's "Combined income," together with some limited breakdown thereof, was shown as $245,332.42, the following appeared:

> "In consideration of $10,000.00 invested in business for each of 3 trusts the partnership has agreed to pay 7% of profits to each of trusts in return the original investment to remain in business & not subject to being withdrawn without consent of partnership
>
> 7% due Celia Paster Trust 17,173.27
> 7% due Donald Paster Trust 17,173.27
> 7% due Eddie Paster Trust 17,173.27

21% totals	51,519.81	
14% due H. Paster for services rendered	34,346.54	
Total Amt. due others		85,866.35"

There was testimony that the above tabulation was prepared by Johnson on instructions from Taran and it was shown to Taran before entries were made therefrom in Mayflower's books. Tabulations similar to that indicating "moneys due others" for the fiscal year 1944 were prepared at the close of the fiscal year ended January 31, 1945, and January 31, 1946, form which credit entries to the "Note Payable—H. Paster, Sam Walzer Trust" account were made, the credit under date of January 31, 1945, being shown as "Profits for year end 1/31/45," as $33,879.66 and that under date of January 31, 1946, as "Profits for fiscal yr end 1/31/46," as $31,680.28.

Taxpayer testified that Mayflower and the trustees agreed that in consideration of the trustees permitting the company to retain the corpus of the trusts in the business and agreeing not to withdraw the funds without Mayflower's consent the company would pay to each trust 7% of its annual profit. There was no written contract covering this alleged agreement as to the profit-sharing arrangement either between taxpayer and the trusts, or between Mayflower and the trusts, or between taxpayer and the named beneficiaries. Taxpayer testified in effect that Taran knew of taxpayer's action in creating the trusts and that he consented to the arrangement by which the trusts were to receive in the aggregate 21% of the profits of the business. Taran, however, was not called as a witness, nor was any other member of the partnership called as a witness.

In the regular course of keeping Mayflower's accounts and in the reporting of its income the amounts credited to the "Note Payable—H. Paster, Sam Walzer Trust" account, and as derived from the 21% of the profits due the three trusts and the 14% of the profits due taxpayer were lumped together on Mayflower's books as selling expenses. The income tax returns for all three years in question listed the so-called income to the trusts as "Selling Expenses" along with taxpayer's salary and bonus in contrast to the treatment of interest on loans and finance fees which were deducted as "administrative expenses". The evidence will be further developed in the course of this opinion.

The Tax Court, based on a consideration of all the evidence made the following, among other, findings:

> "We have since examined and re-examined the transcript and the other evidence of record, and taking into account the record as a whole, we are satisfied and have found as a fact that in so far as the side tabulations of moneys or percentages of profits 'due others' for the fiscal years ended January 31, 1944, 1945 and 1946, the entries made on the Mayflower books and the sheets maintained by Johnson or other records relied on herein tend or purport to show that the amounts in question were the income of the trusts and not the income of petitioner, they were shams and did not reflect the truth."

Having found the issues in favor of respondent the court entered its decision determining that there were deficiencies in petitioner's income tax for the taxable years 1944, 1945 and 1946 in the respective amounts of $40,768.14, $24,588 and $34,637.69.

Petitioner in effect urges that the evidence is insufficient to sustain the decision of the Tax Court and that under

the evidence and the applicable law the income held to be taxable to petitioner was in fact income of the trusts which were valid and irrevocable.

In considering the contentions of petitioner we must have in mind the applicable rules relative to the evaluation of the evidence in this class of cases. In the first place, the transactions involved are within a family group and must be subjected to special scrutiny "lest what is in reality but one economic unit to be multiplied into two or more by devices which, though valid under state law, are not conclusive so far as Sec. 22(a) is concerned." *Helvering v. Clifford*, 309 U.S. 331. The Commissioner determined deficiencies in taxpayer's income tax for the years here involved and that determination is presumed to be correct so that before the Tax Court the burden was upon the taxpayer to prove its incorrectness.

There can be no doubt that the funds purportedly transferred to the taxpayer and his brother-in-law, Sam Walzer, as trustees were the funds of taxpayer and at least prior to their purported transfer they constituted income taxable to him. It is axiomatic that income is taxable to the one who is the source of the income and who has control over its disposition and it is of no consequence for taxation purposes that the one who creates or is responsible for the income does not receive it but channels it into the hands of another. Treasury Regulation 111 promulgated under the Internal Revenue Code of 1939, provides in part that:

> "Income of a trust is taxable to the grantor under section 22(a) although not payable to the grantor himself and not to be applied in satisfaction of his legal obligations if he has retained a control of the trust so complete that he is still in practical effect the owner of its income."

In the instant case taxpayer, from a practical standpoint retained complete control of these so-called trusts. The funds were his; he named himself as trustee together with his brother-in-law; the beneficiaries were members of his family, two of them minors; he in effect loaned the funds to a partnership of which he had complete control and in doing so contracted with that partnership as to the terms of the loan. In fact, under the terms of the trust instruments he and his co-trustee were given complete control over the trust funds and while the trust instruments provided for termination of the trusts the alleged agreement with the partnership provided that the funds could not be withdrawn without the consent of the partnership. In making this alleged agreement the taxpayer made it impossible for the trusts to terminate without the consent of the partnership and the book entries warranted the Tax Court in concluding that the corpus of these so-called trusts and the income therefrom were treated by taxpayer as belonging to him.

It is not the function of the Court of Appeals on petition for review of a decision of the Tax Court to try the case de novo. The Tax Court is a fact finding tribunal and in the instant case the determination of whether the alleged transfers of petitioner's funds rendered him immune from income tax liability was one to be made by the Tax Court and that determination should not be set aside by this court unless clearly erroneous. Not only the facts but the inferences that may reasonably be drawn therefrom are in the first instance at least for the Tax Court to determine. *Boehm* v. *Commissioner*, 326 U.S. 287; *Commissioner* v. *Sunnen*, 333 U.S. 591. We think the Tax Court was warrented in holding that the taxpayer should be treated as owner of the corpus of the alleged trusts and the income arising therefrom. *Helvering* v. *Clifford*, supra; *Commissioner* v. *Sunnen*, supra; *Helvering* v. *Horst*, 311

U. S. 112; *Doll* v. *Commissioner of Internal Revenue*, 8 Cir., 149 F.2d 239; *Yiannias* v. *Commissioner of Internal Revenue*, 8 Cir., 180 F.2d 115. In *Helvering* v. *Clifford*, supra, which was appealed from this court, the basic facts were somewhat similar to those in the instant case in that the taxpayer there, as here, attempted to create a trust. In the course of that opinion it is said:

> "Technical considerations, niceties of the law of trusts or conveyances, or the legal paraphernalia which inventive genius may construct as a refuge from surtaxes should not obscure the basic issue. That issue is whether the grantor after the trust has been established may still be treated under this statutory scheme, as the owner of the corpus. See *Blair* v. *Commissioner*, 300 U.S. 5, 12. In absence of more precise standards or guides supplied by statute or appropriate regulations, the answer to that question must depend on an analysis of the terms of the trust and all the circumstances attendant on its creation and operation. And where the grantor is the trustee and the beneficiaries are members of his family group, special scrutiny of the arrangement is necessary lest what is in reality but one economic unit be multiplied into two or more by devices which, though valid under state law, are not conclusive so far as Sec. 22(a) is concerned.
>
> "In this case we cannot conclude as a matter of law that respondent ceased to be the owner of the corpus after the trust was created. Rather, the short duration of the trust, the fact that the wife was the beneficiary, and the retention of control over the corpus by respondent all lead irresistibly to the conclusion that respondent continued to be the owner for purposes of Sec. 22(a).
>
> "So far as his dominion and control were concerned it sems clear that the trust did not effect any substantial change. In substance his control over the corpus was in all essential respects the same after the

trust was created, as before. The wide powers which he retained included for all practical purposes most of the control which he as an individual would have."

In the instant case taxpayer had in effect the same dominion and control over the corpus of these alleged trusts and the income arising therefrom as he had before the trust agreements were executed. There is no evidence that the cestui ques ever exercised any control over the so-called trust funds.

The teaching of the Clifford case was further amplified and emphasized by the Supreme Court in *Commissioner v. Sunnen*, supra. In that case the paramount issue was whether the taxpaper retained sufficient power and control over property allegedly assigned to his wife to make it reasonable to treat him as the recipient of the income for tax purposes. In the course of the opinion it is, among other things, said:

> "It is in the realm of intra-family assignments and transfers that the *Clifford-Horst* line of cases has peculiar applicability. While specifically relating to short-term family trust, the *Clifford* case makes clear that where the parties to a transfer are members of the same family group, special scrutiny is necessary 'lest what is in reality but one economic unit be multiplied into two or more by devices which, though valid under state law, are not conclusive so far as Sec. 22(a) is concerned.'
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> • • • • • • • •
>
> "The principles which have thus been recognized and developed by the *Clifford* and *Horst* cases, and those following them, are directly applicable to the transfer of patent license contracts between members of the same family. They are guideposts for those who seek to determine in a particular instance whether such an assignor retains sufficient control over the assigned contracts or over the receipt of

income by the assignee to make it fair to impose income tax liability on him.

* * * * * * * * *

"* * * As to the legal foundation of the Tax Court's judgment on the tax consequences of the assignments, we are unable to say that its inferences and conclusions from those facts are unreasonable in the light of the pertinent statutory or administrative provisions or that they are inconsistent with any of the principles enunciated in the *Clifford-Horst* line of cases. Indeed, due regard for those principles leads one inescapably to the Tax Court's result. The taxpayer's purported assignment to his wife of the various license contracts may properly be said to have left him with something more than a memory. He retained very substantial interests in the contracts themselves, as well as power to control the payment of royalties to his wife, thereby satisfying the various criteria of taxability set forth in the *Clifford-Horst* group of cases.

* * * * * * * * *

"* * * Despite the assignments, the license contracts and the royalty payments accruing thereunder remained within the taxpayer's intimate family group. He was able to enjoy, at least indirectly, the benefits received by his wife. And when that fact is added to the legal controls which he retained over the contracts and the royalties, it can fairly be said that the taxpayer retained the substance of all the rights which he had prior to the assignments."

In the instant case not only was the taxpayer in a position to enjoy indirectly the benefits accruing to his wife but also those accruing to his two minor sons.

This court has consistently followed the admonitions of the *Clifford* and *Horst* cases. Thus in *Doll* v. *Commissioner of Internal Revenue*, supra, we said:

"Our immediate concern is (having income taxation in mind) with the third of these rules for construction

of revenue acts—that having to do with the purposes of the taxing act. 'The dominant purpose of the revenue laws (as to incomes) is the taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid' (*Helvering* v. *Horst*, 311 U.S. 112, 119, 61 S.Ct. 144, 85 L.Ed. 75, 131 A.L.R. 655) and this includes 'any economic or financial benefit.' *Commissioner of Internal Revenue* v. *Smith*, 324 U.S. 177, 65 S.Ct. 591. Substance and not form controls in applying income tax statutes and 'the realities of the taxpayer's economic interest, rather than the niceties of the conveyancer's art, should determine the power to tax.' *Helvering* v. *Safe Deposit & Trust Co. of Baltimore*, 316 U.S. 56, 58, 62 S.Ct. 925, 86 L.Ed. 1266, 139 A.L.R. 1513 note 1.

"In view of the rules in the preceding paragraph and of the very broad scope given, in the various revenue acts (here section 22(a) of the 1936 Act, 26 U.S.C.A. Int. Rev. Code Sec. 22(a), to the definition of gross income subject to taxation, the Supreme Court has stated general criteria as aiding in determining tax liability as to income derived from capital, from labor, and from combined capital and labor. Since tax liability on income from capital is based on ownership, the criterion there has to do with possession of attributes of ownership by the taxpayer—such as control by (*Harrison* v. *Schaffner*, 312 U.S. 579, 580, 61 S.Ct. 759, 85 L.Ed. 1055; *Helvering* v. *Horst*, 311 U.S. 112, 119, 61 S.Ct. 144, 85 L.Ed. 75, 131 A.L.R. 655; *Helvering* v. *Clifford*, 309 U.S. 331, 60 S.Ct. 554, 84 L.Ed. 788; *Corliss* v. *Bowers*, 281 U.S. 376, 378, 50 S.Ct. 336, 74 L.Ed. 916) or benefits to him (*Helvering* v. *Horst*, 311 U.S. 112, 119, 61 S.Ct. 144, 85 L.Ed. 75, 131 A.L.R. 655; *Douglas* v. *Willcuts*, 296 U.S. 1, 9, 56 S.Ct. 59, 80 L.Ed. 3, 101 A.L.R. 391).

* * * * * * * *

"A recurring situation is that involving a family group. Usually, a family group is an economic unit. Therefore, as to transactions within such a group

'special scrutiny of the arrangement is necessary lest what is in reality but one economic unit be multiplied into two or more by devices which, though valid under state law, are not conclusive so far as Sec. 22(a) is concerned.' *Helvering* v. *Clifford*, 309 U.S. 331, 335, 60 S.Ct. 554, 84 L.Ed. 788. The test applied in the *Clifford* case was whether a conveyance by taxpayer in trust for his wife had made 'any substantial change in his economic position,' 309 U.S. at page 336, 60 S.Ct. at page 557, 82 L.Ed. 788. The family relationship does not preclude arrangements between its members which will affect tax liability (*Commissioner of Internal Revenue* v. *Branch*, 1 Cir., 114 F.2d 985, 987, 132 A.L.R. 839) but it is 'one of the elements to be considered by the trier of the facts.' *Commissioner of Internal Revenue* v. *Katz*, 7 Cir., 139 F.2d 197, 110.

"We have here a written instrument which is sufficient to create a partnership, both at common law and under Missouri decisions, *Schneider* v. *Schneider*, 347 Mo. 102, 146 S.W.2d 584; *Stone* v. *Guth*, 232 Mo. App. 217, 102 S.W.2d 738. The judgment here is at most an adjudication of what was never in doubt. The existence of such a contract is not determinative of this tax issue. There remains the impact of the test of an analysis of 'all the circumstances attendant on its creation and operation.' *Helvering* v. *Clifford*, 309 U.S. 331, 335, 60 S.Ct. 554, 556, 84 L.Ed. 788. This test must be applied in view of the statutory scheme of taxation prescribed in Sec. 22(a), *Clifford* case, 309 U.S. at page 334, 60 S.Ct. at page 556, 84 L.Ed. 788, and under the special scrutiny arising from the situation that only a husband and wife are parties to the contract. *Clifford* case, 309 U.S. at pages 335-337, 60 S.Ct. at pages 556, 557, 84 L.Ed. 788. The question posed for this analysis is whether this contract caused 'any substantial change in his (petitioner's) economic position.' *Clifford* case, 309 U.S. at page 336, 60 S.Ct. at page 557, 84 L.Ed. 788. The answer is to be found in the pertinent facts. Determination

of such fact situation is the exclusive province of the Tax Court and its decision must be upheld if based upon substantial evidence."

Again in *Yiannias* v. *Commissioner of Internal Revenue*, supra, we said:

"The purpose and intent of the income tax law is taxation to those who earn or otherwise create the right to receive income and a taxpayer may not avoid liability for income tax on his income by assigning the right to receive it."

Taxpayer asserts that the decision of the Tax Court finds no affirmative evidence in its support. There was, however, the determination of the Commissioner of the deficiencies in taxpayer's income tax returns. This was presumptively correct and the burden was on taxpayer to prove otherwise. The proof was without dispute that the corpus of these alleged trusts belonged to the taxpayer and there were the attending circumstances which, except for certain testimony of the taxpayer and the testimony of the bookkeeper of the concern over which taxpayer had complete control and which the Tax Court was not obliged to credit, conclusively showed that the taxpayer had complete dominion and control, with all the attributes of ownership, over these so-called trust funds. There was, as has heretofore been indicated, no evidence that the beneficiaries ever exercised any control over these so-called trust funds. None of them testified; neither did Taran nor Walzer testify. The transactions were given special scrutiny by the Tax Court and the inferences which it drew from all the attending circumstances and its decision that "The profits of Mayflower credited on its books to the 'Note Payable—H. Paster, Sam Walzer Trust' account for each of the fiscal years ended January 31, 1944, 1945 and 1946, were income to petitioner and in so far as the

side tabulations of moneys or percentages of profits 'due others' for each of those years or the entries made on Mayflower's books or the three sheets maintained by Johnson, tend or purport to show otherwise, they are shams and do not reflect the facts" were, we think, fully warranted.

We are of the view that the decision of the Tax Court is abundantly sustained by the evidence and its decision is therefore affirmed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

APPENDIX B.

JUDGMENT.

United States Court of Appeals

for the

Eighth Circuit

No. 15703 ..... September Term, 1956.

Friday, June 21 1957.

Herman Paster,

Petitioner,

vs.

Commissioner of Internal Revenue.

On Petition to Review Decision of the Tax Court of the United States.

This cause came on to be heard on the petition to review the decision of The Tax Court of the United States entered August 22, 1956, which affirmed the action of the Commissioner of Internal Revenue in determining deficiencies in petitioner's income tax for the fiscal years ending January 31, 1944, 1945 and 1946 in the respective amounts of $40,768.14, $24,588 and $34,637.69, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the decision of the said Tax Court, in this cause, by, and the same is hereby, affirmed.

And it is further Ordered by this Court that the said petition to review, in this cause, be, and the same is hereby dismissed.

June 21, 1957.

APPENDIX C.

OPINION OF TAX COURT.

(Not Printed)

Pursuant to Rule 23(i) we have not printed the Opinion of the Tax Court of the United States since we have submitted nine copies of the Record and the opinion is printed at pages 17 to 41, inclusive, of the Record.